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Unusual Remedies a Feature of Mofcom's 6th Conditional Clearance Decision

China's Ministry of Commerce (Mofcom) has approved the proposed acquisition by Swiss pharmaceutical company Novartis AG ("Novartis") of world-leading eye care company Alcon Inc. ("Alcon"), subject to conditions.

The decision, announced on 13 August 2010, is Mofcom's first published merger control decision in almost 10 months, and the sixth time that Mofcom has included conditions in its approval of an M&A transaction under China's Anti-Monopoly Law. Notably, all of these decisions have applied to transactions between foreign multinationals (and the single prohibition decision that has been announced concerned a foreign takeover of a domestic Chinese business).

The latest decision has attracted particular scrutiny because of the unusual nature of the conditions attached to Mofcom's approval. In this legal update, we examine the decision and identify the key learnings that the business sector can draw from it.

Background: The Novartis/Alcon transaction

Novartis purchased a 25% stake in Alcon during 2008, and subsequently announced that it intended to purchase a controlling stake in the company.

One of the key commercial drivers of the deal was the incentive of combining Alcon's world-leadership in ophthalmic surgery products with Ciba Vision – a Novartis subsidiary specialising in contact lenses and related products. According to the Novartis' takeover plan communicated to Mofcom, Alcon would be established as a new Novartis eyecare division, and Novartis would cease some minor overlapping operations in the relevant sector.

The proposed transaction was required to be notified to antitrust agencies in several jurisdictions, including the US, Canada, EU, Singapore and China. Singapore's Competition Commission issued an unconditional clearance decision in relation to the deal in May this year, while the European Commission and Canada's Competition Bureau cleared the deal in early August after Novartis offered to divest its eye care businesses to address competition issues identified in those jurisdictions. The US regulators reached a settlement agreement with Novartis just a few days after Mofcom's decision was published, with Novartis agreeing to sell off a cataracts drug to a third party under that agreement.

Notification to Mofcom and identified competition concern

According to Mofcom's decision notice, Novartis formally notified the proposed transaction in China on 20 April 2010.

After preliminary review, Mofcom determined that the transaction may have the effects of eliminating or restricting competition in relation to two product markets in China:

i. The product market relating to ophthalmic anti-inflammatory and anti-infective compounds (a drug that can be used for the treatment of eye inflammation or infections, especially after ophthalmic surgery, and hereafter referred to for convenience as "medicated eye-care products"); and

ii. The product market relating to contact lens care products,

and thus decided to initiate further review on 17 May 2010. Overall, Mofcom's formal review process in relation to the transaction took just under four months.

According to the decision notice, Mofcom's concerns about the impact of the proposed transaction on these product markets were as follows:

i. Medicated eye-care products

Mofcom determined that the combined market share of Novartis and Alcon in the product market relating to medicated eye-care products would, post-completion, exceed 55% globally and 60% in China. It is notable, however, that the China market share figure was based on Mofcom's determination that Alcon's current China market share was over 60% - while Novartis' share of this China market was less than 1%.

Although Novartis advised Mofcom of its decision to withdraw its existing operations in the global and Chinese market for this type of product, Mofcom appears to have been concerned about the prospect of Novartis seeking to strengthen its position in the relevant market in China by reversing this decision after completion of its acquisition of Alcon.

ii. Contact lens care products

Mofcom determined that the combined market share of Novartis and Alcon in this product market would reach nearly 60% post-completion, which was much greater than the global market share of the parties' main competitors. Additionally, Mofcom determined that the parties would have a market share in China of nearly 20%, making it the second largest player by market share (behind Taiwanese company Haichang Contact Lens Co. Ltd. ("Haichang"), which has a market share in China exceeding 30%).

Mofcom also noted that a Novartis subsidiary had in place a strategic partnership agreement with Haichang, under which Haichang was the exclusive distributor in China of relevant contact lens care products produced by the Novartis subsidiary. Mofcom expressed concern that coordination between Haichang and Novartis/Alcon post-completion could also produce restrictive effects in the market.

Negotiation and determination of remedies

It is clear from the decision notice that Mofcom and Novartis engaged in extended negotiation of remedies with Mofcom to allay the regulator's concerns about the impact of the transaction on relevant product markets in China. Indeed, the notice states that the finalised remedies were reached by consensus. Those remedies are as follows:

1. In order to address Mofcom's concerns about the impact of the transaction in respect of the product market relating to medicated eye-care products, Novartis is required by the end of 2010 to cease its own sales of such products in China. The restriction on such sales will last for a period of five years from the date of Mofcom's decision.
2. In order to address Mofcom's concerns about the impact of the transaction in respect of the product market relating to contact lens care products, Novartis must terminate its strategic partnership agreement with Haichang within 12 months of Mofcom's decision.

In accordance with interim rules that Mofcom published in July regarding the implementation process for merger control remedies, Novartis is required to report to Mofcom regarding its fulfilment of the above conditions, and to appoint a trustee to conduct supervision in respect of the same.

Mofcom's unusual and under-explained remedies

Mofcom's decision to require that Novartis withdraw its medicated eye-care products from the China market may be seen as unusual given Novartis's tiny share of the relevant market in China. Although Novartis had already communicated to Mofcom its intention to effect such withdrawal, it is difficult to ascertain (and certainly the decision notice does not explain) why Mofcom would identify a need to make this a binding commitment for a five year period given that Novartis' existing market share was minor enough to suggest that the merged entity would not be able to materially increase its market power if Novartis continued with its participation in the market in conjunction with Alcon.

Even if Mofcom had legitimate concerns regarding this issue, a more favourable remedy (in terms of benefiting consumers by increasing market choice) may have been to order Novartis to sell its business in the market rather than withdraw it altogether. Again, while there may have been sound reasons for not pursuing this remedy, they are not explained in Mofcom's decision notice.

Mofcom's decision to require that Novartis terminate its strategic partnership agreement with Haichang is perhaps more understandable, given its concern about the potential for ongoing market coordination between two significant players in relation to the supply of contact lens care products in the region. However, while few antitrust analysts would question the validity of Mofcom exploring these concerns during its review process, the decision notice provides little evidence of intensive investigation of the issue. The notice simply states that the relevant agreement may lead to coordination on pricing, sales volumes, and sales regions - and thereby restrict competition - without providing the kind of considered analysis of the actual likelihood and actual market impact of such coordination that is commonplace in the merger review decisions of regulators in more mature competition law jurisdictions.

Conclusion

Notwithstanding the unusual and under-explained remedies imposed by Mofcom in relation to this transaction, there are some encouraging elements to the decision for the wider business sector. In particular, many business operators will welcome the fact that Mofcom continues to be keen to negotiate remedies with parties to transactions that it identifies as raising competition concerns, and is flexible enough to accept proposed remedies that address such concerns even if they are more favourable to the transaction parties than alternatives which could be construed as beneficial to consumers and the broader competitive process of the market.

However, many observers of China's antitrust regime will also have noted the irony in the fact that this decision was announced just a day after Mofcom held a news conference in which it defended its treatment of foreign businesses under the merger control system - notwithstanding that only foreign companies had been subject to remedies in merger clearance decisions until that point. Mofcom's latest merger decision continues that record, and may lead to further questions from foreign commentators regarding whether political pressure is restricting Mofcom's ability to subject domestic transactions to the same level of scrutiny as foreign deals.

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